STATE OF COLORADO

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October 31, 1997

To the Citizens, Governor, and Legislators of the State of Colorado

It is our privilege to present the Comprehensive Annual Financial Report (CAFR) on the operations of the State of Colorado for the fiscal year ended June 30, 1997. This report is prepared by the Office of the State Controller and is submitted pursuant to Colorado Revised Statutes 24 -30-204. The state controller is responsible for managing the finances and financial affairs of the state and is committed to sound financial management and accountability of state government to its citizens.

We believe the financial statements are fairly presented in all material aspects. They are presented in a manner designed to set forth the financial position, results of operations, and changes in fund balances of the various fund types. All required disclosures have been included to assist the members of the General Assembly, the financial community, and the public to understand the state's financial affairs.

The financial statements contained in the CAFR are prepared in conformity with generally accepted accounting principles applicable to government as prescribed by the Governmental Accounting Standards Board (GASB), and are audited by the state auditor of Colorado. In addition to the general purpose financial statements, the CAFR includes: combining financial statements, presenting information by fund; supporting schedules; certain narrative information describing individual funds; and statistical tables and charts presenting financial, economic, and demographic data about the state.

The funds and entities included in the CAFR are those for which the state is financially accountable based on criteria for defining the financial reporting entity prescribed by GASB. The primary government is the legal entity that comprises the funds and account groups of the state, its departments, agencies, and state funded institutions of higher education. It also includes certain university foundations that have been included with the institution that is financially accountable for the foundation.

Discretely presented in the financial statements are component units, which are legally separate entities, for which the state's elected officials are financially accountable. These component units are the following entities:

Colorado Uninsurable Health Insurance Plan
Colorado Water Resources and Power Development Authority
Denver Metropolitan Major League Baseball Stadium District
University of Colorado Hospital Authority

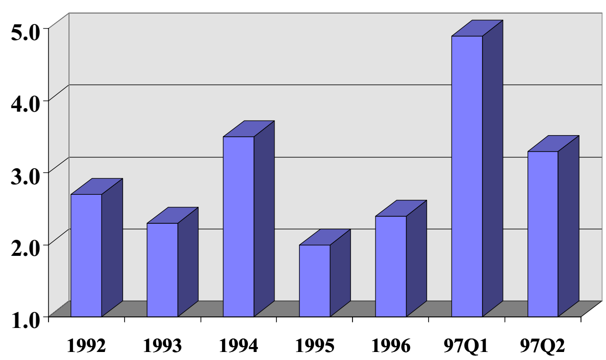
The State Fair Authority, which was presented as a component unit in previous years, was abolished by the legislature effective June 30, 1997, and recreated on the same day as an agency in the Department of Agriculture. Financial information for the separate authority is not presented because unaudited financial statements were not available for its fiscal year ending December 31, 1996 nor for the six months ending June 30, 1997.

Additional information about these component units and other related entities is presented in this report in Note I-A of the footnotes to the general purpose financial statements. With the exception of the State Fair Authority, audited financial reports are available from each of the above entities.

ECONOMIC CONDITION AND OUTLOOK

The U.S. Commerce Department reported that real Gross Domestic Product (GDP), the output of goods and services produced in the United States, increased at an annual rate of 3.3 percent in the second quarter of 1997. This followed a first quarter increase in real GDP at an annual rate of 4.9 percent. The decrease in the rate of growth in the second quarter from the first quarter was primarily due to a decline in the rate of increase in personal consumption expenditures. Real personal consumption only increased 0.9 percent in the second quarter compared to a 5.3 percent increase in the first quarter. However, in the third quarter personal consumption appears to have resumed its strong upward trend. Monthly data concerning retail sales and real personal consumption both revealed identical 0.6 percent expansions in June and July.

PERCENT CHANGE IN REAL GROSS DOMESTIC PRODUCT



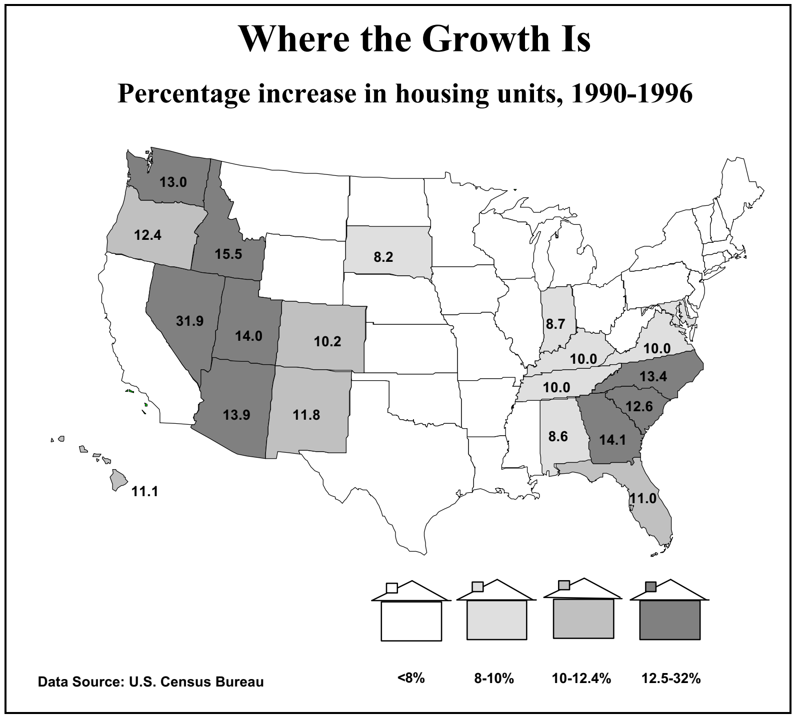
The U.S. Census Bureau reported that income for the typical American household rose in 1996 for the second consecutive year. Median household income rose 1.2 percent to $35,492 after adjustments for inflation. This may be a sign that the nation's economic expansion is spreading its benefits more widely across the population. Some economists caution that even after two consecutive years of improvement, median household income for the nation remains $1,083 below its peak of $36,575 in 1989.

Until early this year, the three-month average of inflation adjusted exports of goods had been growing about 16 percent per year. Since then, growth has surged to 24 percent as of July. Improvements in growth abroad, along with cost cutting and productivity gains in the U.S. have outweighed the negative effects of the dollar's strength. Real world output rose 4.0 percent in 1996 and should grow faster in 1997 according to the International Monetary Fund. Strengthening international markets will provide increasing opportunities for trade and investment, allowing the U.S. export market to expand further.

Colorado's Office of State Planning and Budgeting (OSPB) predicts the real GDP for 1997 will be 3.4 percent, well above the ten-year historic trend of 2.2 percent. However, OSPB also predicts that real annual U.S. growth will fall to an average increase of 2.0 percent per year for the rest of the century, while U.S. inflation may rise from 2.6 percent in 1997 to 3.1 percent in

1999. This moderate inflation environment should allow the Federal Reserve Board to continue its hands-off approach to the economy.

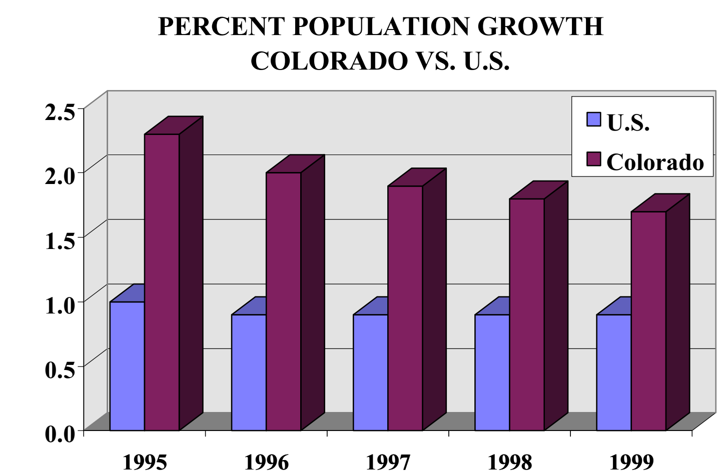
Total Colorado construction is up 3.0 percent year-to-date through July 1997. The strength in nonresidential construction (commercial and institutional) and non-building construction (highways and other heavy construction) is offsetting the decline in the residential sector. Nonresidential construction increased 27.3 percent in 1996 and has increased at a 16.2 percent compound annual average rate since 1990. This sector will lead the state's growth during 1997 and 1998.



Residential construction increased 6.5 percent in 1996 but will decline by 5.0 percent in 1997 and 7.0 percent in 1998 according to estimates from Colorado's Legislative Council. The decline comes primarily in apartment construction while single-family housing will grow at a steady pace.

Residential construction follows migration which peaked in 1993 at 73,000 net in-migrants. In 1996 the number fell 19 percent from 1995 to about 45,000. That was the third consecutive year of decline from the peak year of 1993. OSPB predicts that net in-migration will continue to decline, dropping to 32,000 in the year 2001.

Similarly, Colorado employment growth has also slowed from a peak of 5.1 percent in 1994 to 3.4 percent in 1996. For 1997, OSPB predicts that 65,400 new jobs (3.0 percent increase) will be created in the state by the end of 1997. Solid job growth and a tight labor market has kept unemployment low. The unemployment rate for August 1997 was 3.2 percent statewide and 2.8 percent in the Denver metro area. The state's jobless rate has been low and relatively steady for the first seven months of the year, holding in a narrow 3.1 to 3.5 percent range.



Source: Colorado's Office of State Planning and Budgeting

With unemployment nearing record lows, Colorado's personal income and retail sales have been quite strong. Retail sales in 1996 grew 6.7 percent, well ahead of the 5.1 percent growth in 1995, while U.S. sales decelerated for the third year in a row. Personal income, driven by strong stock market gains, new business formations, and solid employment gains, rose 6.8 percent in 1996, after rising an impressive 8.1 percent in 1995.

The national economy is in good shape, enjoying sustained growth amid low inflation. While economic growth in Colorado has slowed from the early 1990s, it remains on a solid path consistent with the nation. Strength in nonresidential construction, advanced technology, and financial services will continue to fuel growth during the next couple of years.

MAJOR GOVERNMENTAL INITIATIVES

Due to demands for improved transportation and relief from traffic congestion caused by increased vehicle miles traveled in the state, the General Assembly enacted legislation that will divert a portion of the General Fund sales tax to the Highway Users Trust Fund for a period of five years beginning July 1, 1997. It is estimated that the total transfer will amount to $830 million over five years.

Other initiatives involving automobiles included establishing a computerized database to enable the police to determine who has the required mandatory no-fault insurance, revoking the licenses of drivers under 21 who are caught drinking, allowing for the use of slow-moving electric vehicles on non-major city streets, and increasing the fine for residents who do not register their vehicles in the state.

Major changes were made in the state's social assistance programs following the overhaul at the federal level. Welfare will be limited to a maximum of five years, plus recipients have two years to get job training or education. Recipients will also receive help with child care. Legal immigrants will continue to receive state assistance. The state is also implementing the Electronic Benefits Transfer System for social assistance benefits as mandated by the federal government.

BUDGETARY CONTROLS AND ACCOUNTING SYSTEMS

The annual budget of the state for ongoing programs, except for federal and custodial funds, is enacted by the General Assembly. New programs are funded for the first time in the enabling legislation and continued through the Long Appropriations Act in future periods. For the most part, appropriations lapse at the end of the fiscal year unless the state controller approves an appropriation roll -forward required by extenuating circumstances. Capital construction appropria tions are normally effective for three years.

The budget is recorded in the state's accounting system along with federal awards and custodial funds of the various departments. Encumbrances are also recorded and result in a reduction of the budget authority. Encumbrances represent the estimated amount of expenditures that will be incurred when outstanding purchase orders are filled or contracts or other commitments are fulfilled. Open encumbrances in the General Fund are not reported as a reservation of fund balance unless the related appropriations are approved for roll-forward to the subsequent fiscal year. Fund balance is reserved for open encumbrances that represent legal or contractual obligations in the Capital Projects Fund and the Department of Transportation's portion of the Special Revenue Fund.

The state's financial records for governmental type funds are accounted for on a modified accrual basis with the revenues recorded when available and measurable, while expenditures are recorded when goods or services are received or a liability is expected to be liquidated from current available resources. Accounting records for proprietary and fiduciary type funds are maintained on the full accrual basis. That is, revenues are recorded when earned, and expenses, including depreciation, are recorded when incurred.

In developing the state's accounting system, consideration has been given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition. Those controls also assure the reliability of financial records for preparing financial statements and maintaining the accountability for assets.

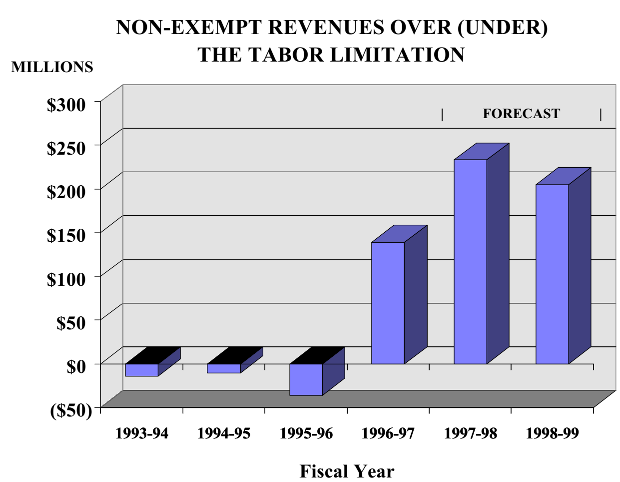
The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from that control. The evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within this framework. We believe that the state's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

FINANCIAL OVERVIEW

Fiscal year 1996-97 is the fourth year of state operations under the TABOR revenue limitations (Article X, Section 20 of the state's constitution). With certain exceptions, the rate of growth of state revenues is limited to the percentage change in the state's population growth plus inflation based on the Denver-Boulder CPI-Urban index. The exceptions include federal funds, gifts and donations, sales of property, refunds, damage recoveries, and transfers.

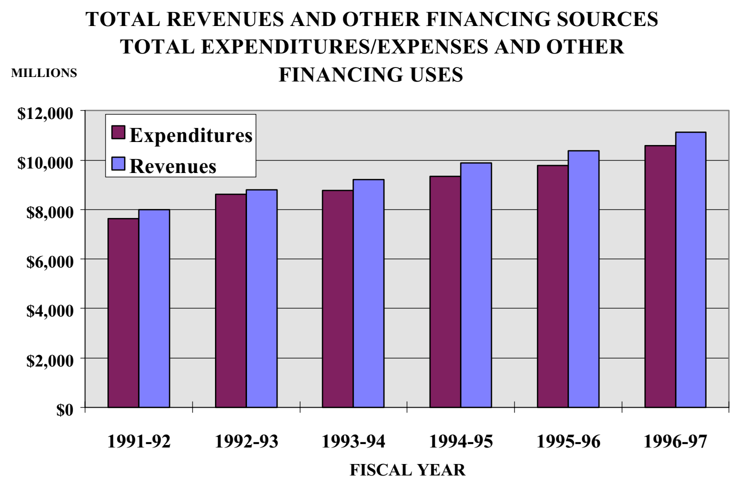
Revenues collected in excess of the limitation must be returned to the citizens unless a vote at the annual election in November allows the state to retain the surplus. TABOR also limits the General Assembly's ability to raise taxes. With the exception of a declared emergency, taxes can only be raised by a vote of the people at the annual election.

In the first three years of operation the state had not exceeded the limitation for revenues. In Fiscal Year 1996-97, state revenues subject to TABOR, were $139.0 million over the limitation. The state recorded a liability in the General Fund at June 30, 1997, for that amount. See Note VI-E Sales Tax Refund, in the notes to the financial statements for additional details.



As the preceding chart indicates, the Office of State Planning and Budgeting forecasts stronger revenue growth than the TABOR amendment allows unless there is a reduction in taxes and/or fees collected by the state. One reason for the large forecasted Fiscal Year 1997-98 increase in the anticipated refund was an unusually large estate tax payment of $78 million that was received in August 1997.

The current combined balance sheet for the state's primary government shows total assets of $11,191 million and liabilities of $4,009 million. Under current accounting principles this difference of $7,182 million is the financial equity that the citizens of Colorado have in their state government. The state's current accounting practices do not include the recording of infrastructure on the state's books. Thus, the recorded equity is exclusive of such assets as highways, bridges, and parks. Similarly, there is no recording of the estimated cost to maintain those assets.



Total revenues and other financing sources for the primary government, excluding operating transfers-in, were $11,134 million and $10,383 million in Fiscal Years 1996-97 and 1995-96, respectively. Total expenditures/expenses and financing uses, excluding operating transfers-out and the TABOR refund, were $10,587 million and $9,790 million for each of the same periods.

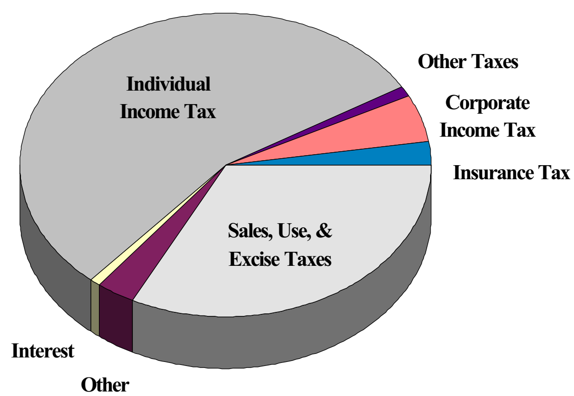
Various fund equity accounts, were larger at the end of the year than at the begin ning, primarily because revenues, other financing sources, and transfers-in exceeded expenditures, other financing uses, and transfers-out for Fiscal Year 1996-97. The equities of the govern mental fund types rose $160.6 million, the combined fund equities of the colleges and universities increased by $160.0 million, and the Trust Funds had an increase of $83.3 million.

GENERAL FUND ACTIVITIES

The General Fund is the focal point to determine the state's financial position. This fund accounts for all revenues and expenditures that are not required by law to be accounted for in other funds. Revenues of the General Fund consist of two broad categories, general purpose revenues and augmenting revenues. General purpose revenues are taxes, fines, and other similar sources that are raised without regard to how they will be spent. Augmenting revenues consist of federal funds, transfers-in, cash fees and charges, or specific user taxes. Augmenting revenues are usually restricted as to how they can be spent.

In the CAFR, all statements depicting the General Fund in the General Purpose Financial Statements Section include general purpose and augmenting revenues. The *Schedule of Revenues, Expenditures, and Changes in Unreserved Fund Balance, Budget and Actual,* presented in the Combining Financial Statements and Schedules Section, includes only the general purpose revenues and expenditures supported by those revenues.

GENERAL PURPOSE REVENUES BY SOURCE

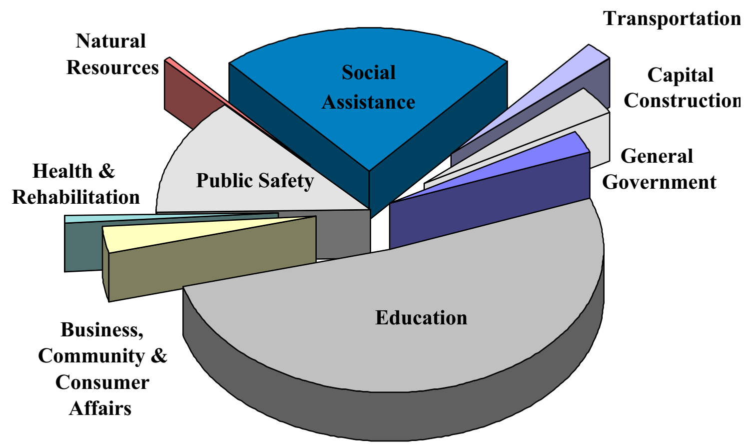


General purpose revenues for Fiscal Years 1996-97 and 1995-96 were $4,679 million and $4,269 million, respectively. Sales and use taxes increased by $104.3 million or 7.9 percent. Individual income taxes increased by $254.1 million or 11.0 percent. These large increases in sales and income taxes demonstrate the continued health of the Colorado economy and robust growth in the state's population during Fiscal Year 1996-97.

Total expenditures and transfers-out funded from general purpose revenues during Fiscal Years 1996-97 and 1995-96 were $4,534 and $4,390 million, respectively. The Departments of Education, Health Care Policy and Financing, Higher Education, and Human Services accounted for approximately 77.9 percent of all Fiscal Year 1996-97 general funded expenditures. Of the departments with substantial general funded expenditures, the Department of Corrections had the largest annual percentage increase at 9.8 percent over the previous year.

In addition to TABOR revenue limitations mentioned under the section "Financial Overview", the total annual increases in general funded expenditures are limited to 6 percent over the previous year with certain adjustments. The primary adjustments are for changes in federal mandates and lawsuits against the state. This limitation is controlled through the legislative budget process.

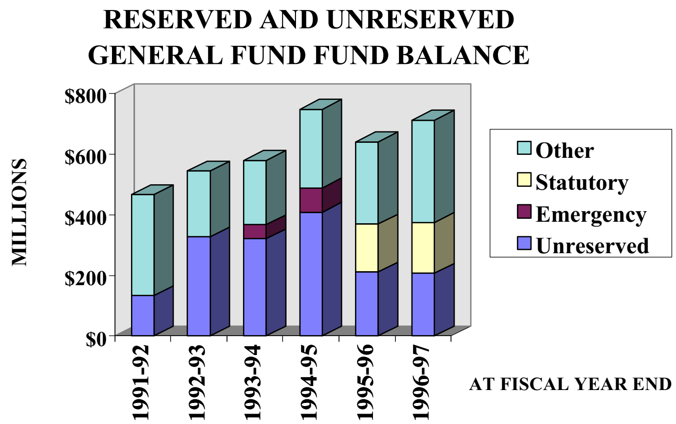
EXPENDITURES BY FUNCTION FROM GENERAL PURPOSE REVENUES



The "Unreserved" title, in the fund equity section of the General Fund on the *Combined Balance Sheet* of the General Purpose Financial Statements, relates to the accumulated net general purpose revenues. The cumulative net augmenting revenues are represented as "Reserved For Other Specific Purposes." Augmenting revenues of the General Fund were $2,089 million and $2,068 million in Fiscal Year 1996-97 and 1995-96, respectively. Federal grants and contracts made up 88.4 percent and 88.7 percent of this amount in each respective fiscal year. The remainder is cash funds, which consist of revenues of specific programs that are statutorily restricted.

During Fiscal Years 1993-94 and 1994-95 a portion of the fund balance was reserved for emergencies as required by Article X, Section 20 (TABOR) of the state constitution. Beginning with Fiscal Year 1995-96, a portion of the fund balance of the Controlled Maintenance Trust Fund is designated by the legislature as the TABOR emergency reserve.

Beginning in Fiscal Year 1995-96, the controller reserved an amount equal to the statutorily required four percent of General Fund appropriation. Prior to that year the four percent reserve was determined during the appropriation process but was not formally recognized in the financial statements.



PROPRIETARY OPERATIONS

Proprietary type funds are accounted for using the full accrual basis of accounting as would a private business. Their operations have many of the attributes of a business in that their revenue relates to the provision of goods or services to the state or to the general public. Capital investments of these operations are recorded within the fund and depreciation is recorded using methods similar to private enterprise. Proprietary funds consist of enterprise funds that provide services to the citizens of the state, and internal service funds that provide services to the state government.

Proprietary fund types had an equity decrease of $2.4 million. A loss of $8.2 million in the State Employees and Officials Insurance Internal Service Fund was offset by earnings in other funds and transfers-in from other fund types or account groups. The Telecommunications Internal Service Fund received $2.7 million of fixed assets funded by the Capital Construction Fund, and the State Fair Authority Enterprise Fund received $4.0 million in cash from the General Fund.

Total fund equity for the proprietary funds at June 30, 1997 and June 30, 1996, were $109.2 million and $111.6 million, respectively. Operating revenues for the proprietary operations were $648.6 million for Fiscal Year 1996-97 and $606.1 million for Fiscal Year 1994-95. Operating expenses were $608.6 million and $563.4 million, respectively. During Fiscal Year 1996-97, the major transfers from the Lottery Fund were $34.3 million to the Conservation Trust Fund and $8.6 million to the Wildlife Fund. In addition, $51.5 million was distributed from the Lottery Fund's net proceeds to the Great Outdoors Colorado Trust Fund, a constitutionally created public authority.

DEBT ADMINISTRATION

The State of Colorado is prohibited by its constitution from incurring any general obligation debt. Many higher education institutions have issued bonds and notes with revenues pledged from specific user payments to retire these bonds and notes. Additional information is provided in the footnotes to the general purpose financial statements and the statistical section of this report.

CASH MANAGEMENT

Statutes permit the state treasurer to invest cash not needed immediately to pay obligations of the state. These investments may consist of obligations of the United States, commercial paper of prime quality, repurchase agreements, bank acceptance agreements, and other investment instruments. The treasurer also invests the funds of the Colorado Compensation Insurance Authority, the Colorado Water Resources and Power Development Authority, and the Great Outdoors Colorado Trust Fund. At June 30, 1997 the state treasurer held the following investments at book value:

Investment Type	Amount in Millions
United States Treasury and Agencies	$1,820.6
Asset Backed Securities	713.7
Mortgages	356.6
Commercial Paper	293.3
Bankers' Acceptance	217.1
Corporate Bonds	202.9
Repurchase Agreements	24.9
Other	0.4
TOTAL	$3,629.5

RISK MANAGEMENT

The state self-insures its agencies, officials, and employees for the risks of losses for general liability, motor vehicle liability, workers' compensation, and medical claims. Prior to Fiscal Year 1995-96, the Risk Management Fund, an internal service fund, was used for this purpose. However, because the claim reserves were not being funded during Fiscal Year 1995-96, the state began using the General Fund (as required by current accounting pronouncements) for all claims or judgments except for employee medical claims. (See Notes I-E, IV-D, and IV-F to the General Purpose Financial Statements). Medical claims for officials and employees are managed through the State Employees and Officials Insurance Fund, an internal service fund. Property claims are not self-insured, as the state has purchased insurance. (See Note IV-F to the General Purpose Financial Statements.)

The Regents of the University of Colorado are self-insured for workers' compensation, auto, general and property liability, and official's and employee's medical claims. The university's medical claims are handled by a third party through a contractual agreement. The university has also purchased stop-loss insurance for individual medical claims in excess of $500,000. (See Note IV-F to the General Purpose Financial Statements.)

INDEPENDENT AUDIT

The audit of the General Purpose Financial Statements was performed by the state auditor. The opinion of the auditor is on page 23 of this report preceding the financial statements. Besides an audit of the statewide financial statements, the auditor will from time to time audit the financial statements and operations of various departments and institutions within state government.

In 1996, the United States Congress amended the Single Audit Act of 1984. The amended act clarifies the state's and the auditor's responsibility for ensuring that the use and accounting for federal moneys is proper. Under the requirements of this act, transactions of major federal programs are tested. The state prepares a Schedule of Expenditures of Federal Awards for inclusion in the state auditor's Statewide Single Audit Report. The state auditor issues reports on the schedule, the financial statements, internal controls, and compliance with the requirements of federal assistance programs.

ACKNOWLEDGMENTS

In conclusion, I thank my staff and the staffs of all the state departments and institutions whose time and dedication have made this report possible, and further, I reaffirm our commitment to maintain the highest standards of accountability in financial reporting.

Sincerely,

Clifford W. Hall
State Controller